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DEPARTMENT OF CONSUMER & INDUSTRY SERVICES
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**DATE:** September 5, 2003

**LETTER NO.:** 2003-CU-05

**TO:** The Board of Directors and Management of Michigan State-Chartered Credit Unions

**SUBJECT:** 2003 Second Quarter Financial Results

OFIS compiles call report information to monitor Michigan state-chartered credit unions, both individually, and in the aggregate. The purpose of this letter is to share some overall industry trends and highlight certain areas of particular concern based on the June 30, 2003 call report filings.

**<u>Summary</u>**

Overall, Michigan's 273 state-chartered credit unions (excluding CenCorp) remain in sound financial condition and continue to provide quality services to their members. Credit union membership remained stable for the quarter at 2.67 million. The rate of asset growth declined from the previous quarter, but remains high. State-chartered credit unions now hold total assets of $17.74 billion. Consolidated earnings remained stable with a computed Return on Average Assets (ROAA) of .86% maintaining a relatively stable net worth ratio. However, the number of institutions reporting relatively low net worth ratios continues to be high. Loan growth improved significantly from the first quarter with an annualized growth of 13.54%, making this the first quarter since December 31, 2000, where loan growth outpaced asset growth. Total loans now exceed $10 billion. Loan delinquency and charge-offs remained stable overall, but an increasing number of credit unions reported a significant increase in delinquency and loan losses over the past twelve months.

Areas of regulatory concern identified in our analysis of the June 30, 2003 call report information include the following:

**<u>More Credit Unions Report Increased Delinquency and Loan Losses</u>**

Overall delinquency and net charge-offs remained stable at 0.95% and 0.47% (respectively) during the quarter. However, twenty-three credit unions had an increase in the net charge-off ratio of more than 100 basis points over the last twelve months, compared to two as of March 31, 2003. Twenty-two credit unions had a net charge-off ratio over 1.5% at June 30, 2003, two less than March 31, 2003. Also, thirty-two credit unions had an increase in the delinquency ratio of more than 100 basis points over the last twelve months, compared to three reported last quarter. The number of credit unions with delinquency ratios exceeding 3% remained at thirty-one.

Credit unions experiencing sharp increases in delinquency and loan losses should take immediate action to determine what factors, whether internal or external, contributed to the adverse trends. Policies and procedures should be developed to address these factors.

**High Asset Growth**

The growth rate for all Michigan state-chartered credit unions remained high at 13.45% (annualized) for the second quarter of 2003, but was down considerably from the 22.25% reported for the first quarter of 2003. Forty credit unions reported annualized asset growth over 20% at June 30, 2003, less than one third of the number reported at March 31, 2003.

While asset growth declined in the second quarter, the increase in dollar amount of total assets for the first half of 2003 was nearly equal to the total increase for all of 2002.

*Unplanned or poorly managed growth can cause operational problems and erode earnings and net worth. Boards and management teams should carefully review their credit union's asset growth relative to loan demand and net worth position. The incremental net margin on additional funds acquired should be evaluated by comparing the cost of funds to the return available on safe, liquid investments. Dividend and interest rates paid on member savings should be managed to ensure growth is controlled and an adequate level of earnings maintained.*

**High Number of Institutions Reporting Net Worth Ratios Below 8%**

While the net worth ratio in aggregate has stabilized, thirty credit unions reported ratios under 8% as of June 30, 2003. Of those institutions, five meet "adequately capitalized" guidelines as defined by Part 702 of the NCUA's Rules and Regulations. Two institutions are defined as "undercapitalized" and one "critically undercapitalized".

**Conclusion**

Prudent risk management includes timely identification and quantification of potential risks and adverse trends, and taking appropriate steps to ensure risks are properly managed. Directors and management teams must monitor the financial condition of their credit union on an ongoing basis to ensure satisfactory performance and safe and sound operations are maintained.

**A written plan of action should be developed when adverse trends or financial conditions are identified.** This plan of action serves to document your board's awareness of the problem and intended actions to control and correct the adverse conditions.

I hope the information in this letter is helpful in making informed business decisions. Operating a financial institution safely and soundly requires diligence in risk identification, measurement, and management. The stresses evident in the September 2002 statistics highlight the need for application of sound management practices in an increasingly uncertain economic environment.

Sincerely,

Roger W. Little, Deputy Commissioner
Credit Union Division